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Government Relations

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TO: Dennis Fay, Executive Director  
Alameda County Congestion Management Agency

FR: Lynn M. Suter & Associates

RE: Legislative Update – May Revise

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***“Put yourself in the financial community’s perspective and you’ll understand why nobody in their right mind would lend money to this state if we don’t have a new tax.” -Steve Peace, Director of State Finance***

***California was among the first States in the Union to accurately forecast the impact of the deteriorating national economy on State Revenues.*** With this dubious honor highlighted in its opening pages, the May Revision Budget is now before us. Urgency was the heralded message, hammered home by Governor Davis and Director of Finance Steve Peace at their press conference today. But--the sheer size of the debt, limited options for paying it off, and entrenched political blockades could stymie the Administration’s emphatic admonition that the proposal only works if a budget is adopted by the June 30 deadline. If agreement is reached before the close of the fiscal year, it can only happen with adoption of broad outlines. The details could stretch out over months.

***Restating the Painfully Obvious:*** Even for the appropriately named Gray Davis, the Governor’s May Budget Revision speech this afternoon was a particularly somber one. This latest iteration pegs the state deficit at \$38.2 billion. The increase is largely attributable to the shortfall in adopted current year cuts, abandonment of plans to further securitize state tobacco settlement payments and caseload increase. Davis threw in the towel on erasing the deficit in one year, a January proposal he couldn’t sell to either Democrats or Republicans for diverse reasons. These same reasons—Democratic opposition to program cuts and Republican aversion to tax increases—reverberated in Capitol hallways today.

***A long, long way from January to May:*** Wall Street warnings, an attempt to placate both Dem and Rep policy demands, and his wretched polling numbers all

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contributed to a major revision of the Gov's early budget design. Some things got better for local agencies. The Revise proposal restores \$708 million to K-12 education from the January hit list, cancels the Governor's January proposal to cut SSI/SSP, restores a proposed 6.2% reduction in CalWORKS grant levels and reduces his state/local program realignment proposal from \$8.3 billion to \$1.8 billion. Other proposals suspend and defer mandates (see list included) and eliminate some Medi-Cal optional benefits. Major cuts in health and Welfare programs remain.

The Mayvise Plan depends upon tax increases and spread-out borrowing to stitch up the gaping cavern in current year revenues.

***"Wall Street can say what it wants. Their job is to maximize profits and not to look out for the interests of Californians" – Jim Brulte, Senate Republican Leader***

***Deficit Financing – Trading a Current Solution for Future Folly?*** Admittedly there are no easy answers for this administration or this legislature. The situation is too dire and dependent upon too many unruly factors. The Governor abandoned his January proposal for a single-year deficit solution, and now proposes issuance of a \$10.7 billion Deficit Financing Bond (current year shortfall) to be paid off over five or more years with a half cent sales tax increase. The increase would be temporary and revert to current levels upon payment of the debt. Proposed new revenue also includes an increased tax on the highest income level brackets of half the amount Davis proposed in January, and an increase in the tobacco excise tax by amounts significantly lower than the January proposal. The latter two increases would fund the state/local program realignment proposal. These revisions mean the "structural deficit" – an annual shortfall of \$7.9 billion – would kick in by July, 2004.

***"After all we've done, the Republicans have not moved an inch. It's time to get real. . .this is about governing, and we have jobs to do." -Assembly Speaker Herb Wesson***

***Fishing Expedition or Bait 'n' Switch?*** Shortly after the Gov's press conference Senate Republican leader Jim Brulte told a mass gathering of local officials that his caucus would not supply the votes needed for a half cent sales tax increase. While it takes a 2/3 majority vote to approve a tax increase, it takes only a majority vote to change allocation of the revenue. Brulte told the group that Dems have played "bait and switch" in the past, and may do so again.

***Crumbling Structure or Solid Reform?*** Insistence upon "structural reform" continues to be a mantra in most quarters. Just what this means, especially to local governments, is up for grabs. The Governor's proposal specifically suggests mid-year spending reduction authority for the Governor, including suspension of entitlement statutes—a concept embraced by some legislators on

both sides of the aisle. It also proposes more flexibility for local governments to generate revenues and administer programs. Whether or not the economy will recover sufficiently to make a dent in the \$7.9 billion future “structural problem” is left for a crystal ball to decide.

***The Elusive VLF Backfill:*** The biggest unanswered question for local governments is the Vehicle License Fee backfill. The Mayvise assumes current statute will trigger a raise in the fee totaling \$3.9 billion when the revenue shortfall reaches a defined level. The Gov predicted this would be “by July 1.” *The Mayvise proposal therefore does not provide for state backfill of losses to cities and counties for reduced VLF revenues.*

*But—the proposal also assumes the statutory trigger and lack of backfill results in a General Fund savings of \$947 million over the proposed January 10 budget.*

***Mysterious Math:*** Is this assumption magic? What does it mean for local agencies? How can the state general fund save \$947 million, NOT backfill local governments, and come out even for cities and counties? Assuming the Administration’s murky estimate that the trigger “might” be pulled July 1, it could take three months for increased revenues to flow. “Might” local governments be faced with eating close to \$1 billion if one fiscal quarter is lost in collections? These questions were answered to the satisfaction of absolutely nobody in today’s press conference and subsequent briefings by the Department of Finance. Stay tuned as we dig for answers in coming days.

***“Fund them or suspend them. It doesn’t matter. Deferred mandates will never be paid.” – Jim Brulte, Senate Republican Leader***

The Governor’s January Budget proposed continuation of the deferrals of all mandate reimbursement payments. The May Revise proposes to suspend/repeal 35 mandates in 2003-04 and 2004-05. Specifically, the Open Meeting Act Notices mandate is proposed for repeal in 2003-04 (\$32.9 million reduction), while 27 of the remaining 34 mandates are proposed for repeal in 2004-05. The balance of the mandates are proposed for suspension only. Please find the full list below.

Below is a link to the May Revise document itself:

[http://www.dof.ca.gov/HTML/BUD\\_DOCS/May\\_Revision\\_2003\\_www.pdf](http://www.dof.ca.gov/HTML/BUD_DOCS/May_Revision_2003_www.pdf)

Highlights affecting local agencies are noted below. Please call us if you have questions or need further information. We will send additional details as they become available through briefings in the next few days.

**Bridging the Budget Gap:** The Governor's May Revision for the 2003-04 Budget estimates that the budget gap has grown by \$3.6 billion for a budget gap of \$38.2 billion. Along with this growing deficit, the Governor announced that he has reluctantly agreed to roll-over the current year deficit of \$10.7 billion, which would be financed by a temporary 1/2 cent increase in the sales tax. The following outlines how the Governor proposes to address the budget deficit.

<b>Governor's May Revision</b> <b>Addressing the Overall \$38.2 billion Gap</b> <b>(in millions)</b>				
<b>Solution Type</b>	<b>Jan. 10</b>	<b>%</b>	<b>May Revision</b>	<b>%</b>
Cuts / Savings	\$20,728.3	59.9%	\$18,875.4	49.4%
Realignment (Paid for with Tax Increase)	8,154.0	23.6	1,732.4	4.5
Fund Shifts	1902.7	5.5	2,076.3	5.5
Transfers	2114.3	6.1	1,912.6	5.0
Loans / Borrowing	1683.3	4.9	2,901.5	7.6
Deficit Financing	--	--	10,700.0	28.0
<b>Total</b>	<b>\$34,582.7</b>	<b>100.0%</b>	<b>\$38,198.2</b>	<b>100%</b>

Source: Assembly Committee on Budget

**Deficit Financing Bond:** The Governor's acceptance to finance the current year deficit of \$10.7 came with three conditions. The Governor insists that it is financed with a new independent revenue source; that the Legislature must pass the Budget on time; and the Legislature must continue its work on the structural deficit after the passage of the Budget.

The Governor proposes to increase the sales tax by 1/2 cent and dedicate this revenue to repaying the bonds. A 1/2 cent increase would generate about \$2.4 billion a year. These new revenues would be placed in a newly created special fund. These new revenues would not be required to be included in the Proposition 98 calculation, as new revenues that are dedicated to a special fund are excluded from General Fund revenues for purposes of that calculation. In addition, financial institutions are given added security because the Legislature

could not appropriate special fund revenue for any other purpose other than its intended purpose. It is the Governor's intent that this sales tax increase would automatically sunset once the bonds are paid off, which is estimated at 5 years.

**Reimbursable State Mandated Local Programs:** In the 2002-03 budget act non-education mandates payments are deferred until the 2003-04 fiscal year. The 2003-04 budget proposes to extend this deferral. This preserves a local government's obligation to perform the mandate with the commitment that the state will reimburse it in the future with interest.

The May Revise takes this issue a step further by proposing to suspend 34 mandates, and to repeal the mandate that require local governments to post agendas regarding items to be considered at public meetings. It is the Governor's position that any responsible public agency should post agendas without being mandated.

Suspending mandates rather than repealing them forces a local government to decide if it should continue to provide the service at its own cost. In addition, suspending mandates raises concerns regarding the local government's liability for failing to provide a service that it has regularly provided for several years. Therefore, the Administration proposes to repeal several mandates starting in 2004-05.

**Mandates Proposed for Suspension in 2003-04 and Repeal in 2004-05**

<b>Mandate</b>	<b>Departmental Budget</b>
Deaf Teletype Equipment	Office of Emergency Services
CPR Pocket Masks	Office of Emergency Services
Misdemeanors: Booking and Fingerprinting	Justice
Voter Registration Roll Purge	Secretary of State
Handicapped Voter Access Information	Secretary of State
Local Elections Consolidation	Secretary of State
Democratic Party Presidential Delegates	Secretary of State
Election Materials	Secretary of State
Victims' Statements (Minors)	Board of Corrections
Animal Adoption	Food and Agriculture
Elder Abuse, Law Enforcement Training	Peace Officers Standards and Training
Law Enforcement Sexual Harassment Training	Peace Officers Standards and Training
Personal Alarm Devices	Industrial Relations
Adult Felony Restitution	Victims Compensation and Government Claims Board
Property Tax-Family Transfers	Tax Relief
Senior Citizens' Mobile Home Property Tax Deferral	Tax Relief
Proration of Fines and Court Audits	Local Government Financing
Open Meetings Act Notices*	Local Government Financing
Filipino Employee Surveys	Local Government Financing
Involuntary Lien Notices	Local Government Financing

Lis Pendens	Local Government Financing
SIDS Contacts by Local Health Officers	Health Services
SIDS Notices	Health Services
Guardianship/Conservatorship Filings	Developmental Services
Short-Doyle Case Management	Mental Health
Short-Doyle Audits	Mental Health
Residential Care Services	Mental Health

#### **Mandates Proposed for Suspension in 2003-04**

<b>Mandate</b>	<b>Departmental Budget</b>
Structural and Wildland Firefighter Safety Clothing and Equipment	Industrial Relations
Domestic Violence Information	Local Government Financing
Two Way Traffic Signals	Caltrans
Mineral Resource Policies	Conservation
Investment Reports	State Treasurer's Office
County Treasury Oversight Committees	State Treasurer's Office
Child Abuse Treatment Services Authorization and Case Management	Social Services

\*proposed for repeal in 2003-04

Source: Department of Finance

## **Transportation Issues**

**State Transit Assistance (STA):** The May Revise proposes to cap STA expenditures at \$100.4 million as specified in the January budget proposal. By placing a cap on these funds an estimated \$87.4 million in anticipated "spillover" funds is diverted back to the general fund. The Department of Finance estimates that the spillover could reach \$174.8 million, half of which would normally flow into the STA.

**Proposition 42:** The May Revise makes a significant departure from the January budget with respect to suspending Proposition 42. The Governor proposes to transfer only \$207 million from the general fund to Proposition 42. This transfer is intended to provide sufficient funds to meet the cash requirements of Traffic Congestion Relief Fund (TCRF) projects that received an allocation vote from the CTC prior to December 2002. Of this amount, \$157.5 million would be earmarked for TCRF projects that received allocation votes before December 2002. The remaining \$49.5 million would be used to fund Caltrans staffing of TCRF projects.

The Governor proposes to suspend of the transfer from the general fund to the TIF the remaining \$938 million of Proposition 42 funds. As a result no Proposition 42 funding would be allocated to the STIP, Local Streets & Roads, or the Public Transportation Account. *However, according to the May Revise the general fund shall be obligated to repay the TIF for the amount of the transfer that is suspended.*

The Assembly Budget Subcommittee's proposal outlined below marks the starting point for negotiations between the Governor's proposal that retains in the general fund \$1.1 billion in transportation funds (this includes \$938 million in Proposition 42 funds and \$174.8 million in spill over funds) and the Subcommittee's proposal that sends \$500 million to the general fund.

**Project Delivery Workload:** The Revise also proposes to increase Caltrans' staffing budget by \$98.4 million to reflect an updated project delivery workload. This staffing level includes workload for the non-Traffic Congestion Relief Fund components.

**High-Speed Rail Authority Consolidation:** The Governor proposes to drop his proposal to consolidate the High-Speed Rail Authority (Authority) within Caltrans as proposed in the Governor's January Budget.

**Financial Assistance to Local Governments:** The May Revise continues to provide funding for technology grants to local law enforcement (\$18.5 million), grants to small and rural county sheriffs (\$18.5 million), and the Citizens Option for Public Safety (COPS) and Juvenile Crime Prevention programs are fully funded at \$116.3 million each. City reimbursement for booking fees was not restored in the Governor Budget

**Assembly Budget Subcommittee #5 Action on Transportation Funding:** In contrast to the Governor's May Revise proposal the Assembly Budget Subcommittee #5 adopted a comprehensive package of loans and fund shifts that assures the health of several transportation funding programs, while providing a \$500 million loan to the general fund.

The Assembly Budget Subcommittee #5 on Transportation formally rejected the Governor's proposal to suspend Proposition 42, and in exchange agreed to loan \$500 million of Proposition 42 funds back to the general fund. This loan would be repaid pursuant to a schedule that will be specified in statute and will take into consideration the cash flow needs of Traffic Congestion Relief Program (TCRP) projects. This was approved on a party line vote with the Republican members abstaining.

The proposal would loan \$220 million of the \$678 million dedicated to TCRP projects to the general fund. This would leave \$458 million available for existing and new TCRP allocations in the 2003-04 fiscal year. This ensures funding will be available for TCRP projects currently under contract, and would allow the CTC to approve new allocations.

The remaining \$280 million would be loaned from the Transportation Improvement Fund (TIF) subaccounts that consist of the 40% STIP allocation,

40% local streets and roads allocation, and the 20% PTA allocation. Pursuant to language currently contained in AB 1748, which contains numerous state and local budget cut proposals, the PTA would loan \$56 million, the STIP allocation would loan \$112 million, and the local streets and roads allocation would loan \$112 million. Even with these loans, each of these subaccounts would be net winners.

In addition, the proposal adopted by the Subcommittee would divert any “spill over” funds from the PTA and allocate those funds pursuant to the TIF subaccounts, or 40% to STIP projects, 40% to local streets and roads, and 20% to the PTA. If gas prices remain above \$1.90 per gallon the LAO estimates the spill over will reach \$190 million. While this is a significant blow to potential PTA funding, this proposal far exceeds the funding levels proposed by the Governor.

If this proposal holds firm and revenue projections for a \$190 million spill over are realized, this proposal would result in an additional \$132.8 million for STIP projects, \$132.8 million for local streets and roads, and \$66.4 million for the PTA, or an additional \$33.2 million for STA for a total of \$133.2 million for 2003-04.